Economists: Tough economic sledding will get smoother by year's end

March 18 2008

With the housing market still skidding, consumers tightening their belts and the job market clearly weakening, the first half of this year will continue to be tough for the U.S. economy. But it gets better later this year and next, say University of Michigan economists.

"The economy is clearly in a fragile condition," said Saul Hymans, U-M professor emeritus of economics. "The housing industry continues to be a substantial drag on the economy. Declining home values and the credit crunch that followed the subprime mortgage fiasco are putting the brakes on household and business spending, as well.

"The talk in the press is dominated by the consideration of whether the economy is about to slip into a recession or has already done so. Whether or not economic conditions turn out to be weak enough for a recession to be declared, there can be little doubt that the economy is now and will feel subpar, at least in the near term."

In their annual spring forecast update of the U.S. economy, Hymans and colleagues Joan Crary and Janet Wolfe predict a 1.5 percent decline in national economic output growth (as measured by real Gross Domestic Product) for the current quarter—a drop of $44 billion. But a "no-growth" second quarter, thanks to smaller declines in vehicle sales, nondurable consumption and residential construction, gives reason for hope.

"Some of this second-quarter improvement is undoubtedly due to the tax rebate checks that come through in May and June, but the fiscal stimulus has much larger effects in the second half of this year," Hymans said.

According to the forecast, the weak pattern of GDP growth during the first half of 2008 is followed by a 2.5 percent growth rate during the second half and an even stronger 2.9 percent gain in real GDP during 2009.

The growth pattern, say Hymans and colleagues, is supported by light vehicle sales stabilizing at a 15.1-million-unit pace through next year (down from 16.1 million units in 2007) and an increase in housing starts of more than 30 percent during 2009—after hitting rock bottom later this year and totaling the fewest single-family housing starts since 1982.

Overall, housing starts (both single- and multi-family) will number less than 1 million this year, down from more than 2 million in 2005, 1.81 million in 2006 and 1.34 million last year, they say. Next year, housing starts are forecast to rise to 1.14 million.

Existing single-family home sales will drop to 3.95 million units this year and 3.78 million in 2009—a loss of more than 1 million units from last year, the economists say. Three years ago, more than 6 million homes were sold in the United States.

The forecast also calls for continuing job losses through the summer, followed by modest job growth later this year and next, resulting in no gain in the annual job count in 2008 and an increase of about half a million in 2009. The unemployment rate will move up from a current reading of 4.8 percent to hover around 5.6 percent and 5.8 percent through the end of next year.

Interest rates will continue to fall, Hymans and colleagues say. Conventional mortgage rates will average 5.9 percent this year and 5.7

percent in 2009 (down from 6.3 percent last year), while T-bill rates stay below 2 percent this year and next (down from 4.4 percent in 2007).

Finally, the price of oil should back off from current levels of about $110 per barrel to an average of $88 per barrel in 2009, while core inflation should remain in check at about 2.5 percent this year and next, they say. Consumer spending will remain low, as well, growing by just about 1 percent in 2008, before heading back up next year at a 2 percent rate—still down from the 3 percent growth in spending of the past two years.

The U-M forecast is based on the Michigan Quarterly Econometric Model of the U.S. Economy and compiled by the U-M Research Seminar in Quantitative Economics.

Source: University of Michigan