Recent Developments on the National Economy

The news at the national level has generally been upbeat of late, leading many commentators to conclude that the long-awaited pickup in the economy has arrived. Getting special attention has been new life in the long-dormant housing sector. As shown in the chart below, permits for single-family homes have been on a steady upward march for more than a year. Meanwhile, prices of existing homes have been rising briskly in recent months, as shown in the next chart. The revival in home prices has been helping to lift equity positions in homes and household net worth,
which is enabling some families to trade up and encouraging consumers to spend on other things. Improving wealth positions are contributing to a firming in the demand for autos and other light vehicles, shown below. Sales of light vehicles in June returned to levels last seen before the Great Recession (shaded area).

At the same time, conditions in the labor market have been improving. Even though the unemployment rate has stayed in the 7-1/2 percent area for several months, the labor force participation rate has turned up (which is acting to hold the unemployment rate up) at a time when job gains in the private sector have been running at a solid 200 thousand per month pace. The better tone to the labor market likely has started to draw some people back to the labor force, which is boosting participation. Brisker employment gains are also helping to fill vacant office buildings and reduce the overhang of commercial properties.
Meanwhile, businesses’ orders for new capital goods—the principal component of business investment—have resumed expanding after a pause in 2012, chart below.

Accompanying improvements in the housing, motor vehicle, and labor markets, consumer sentiment has strengthened to the highest level of the current recovery, next chart.

Moreover, these positive spending developments have been occurring at a time of considerable fiscal headwinds after the tax increases that went into effect on January 1 and the sequester cuts on March 1. No doubt some of the stronger business and consumer spending reflects pent-up demands for things that had been postponed for years because of the weak economy and very tight loan markets.

Nonetheless, recent readings point to a long-overdue upturn in output growth. This should result in growth in real GDP climbing above the stubborn 2 percent track that it has been stuck in throughout this recovery—see chart below. No doubt, the Fed’s unprecedented monetary stimulus has been taking hold. Faster growth will lead to a brisker job market and clearly be welcomed by the Fed.
Since the FOMC’s announcement and Chairman Bernanke’s press conference on June 19, financial markets have been in a tizzy. The stock market sold off sharply and the yield on the key ten-year Treasury note shot up, next chart (below). Why?

What’s the Fed Up To?

![Graph showing Real Gross Domestic Product and 10-Year Treasury Constant Maturity Rate](image-url)
Evidently, market participants reacted to the suggestion that the Fed might be planning to “taper” down its large-scale purchases of Treasury and mortgage-backed securities from the current pace of $85 billion per month (more than $1 trillion per year!) sooner than had been expected.

To put things in perspective, the Fed has held its policy interest rate—the federal funds rate—at zero for more than four and one-half years. It has supplemented this with “forward guidance,” specifying that it does not intend to begin to lift this rate off rock bottom at least until the unemployment rate falls to 6-1/2 percent, and will continue to pursue its aggressive asset purchase program until the labor market improves “substantially.” Chairman Bernanke noted that, in light of the FOMC members’ projections of faster growth, they were envisioning a moderation in the monthly rate of asset purchases by year-end and an ending of purchases of new assets altogether by mid-2014. The subsequent tanking of financial markets brought forth a bevy of public comments by Fed officials who attempted to assuage the markets by reminding participants that a winding down of the program would still leave monetary policy in an extremely accommodative mode, and that the tapering would only be undertaken if the economy improves as expected. This commentary seems to have had little effect.

A lesson to be learned from this episode is that financial markets are highly dependent on this massive monetary stimulus, and actions to wean the markets from it are likely to have rocky consequences. It seems that the Fed will now step up its efforts to improve clarification of its intentions to avoid even larger counterproductive financial market reactions as the day for moving toward a normalization of monetary policy draws closer. Even so, one can expect more market fallout from prospective Fed actions taken to reduce the degree of accommodation, and renewed bouts of volatility.

Also worrisome is low inflation. The chart below illustrates that core inflation—excluding volatile food and energy prices—has dropped to the vicinity of 1 percent, well below the Fed’s 2 percent target. With still-considerable slack in the economy, there is a risk that inflation could drift even lower—adding to the challenges facing monetary policy.
Even if economic growth improves over the coming years as expected, the federal fiscal situation is still a dark cloud on the horizon. The fiscal measures that kicked in earlier this year will make a deposit toward limiting the budget erosion that begins later this decade and worsens later on. The chart below illustrates that, under existing legislation, the ratio of debt to GDP—at a peacetime high—will ease off only a bit in the coming years before it resumes an upward trend that continues well beyond the end of this chart. Moreover, it should be emphasized that the chart is based on fiscal projections based on current legislation. This includes unrealistic rollbacks of such things as Medicare compensation rates and a presumption that politicians will resist the temptation to enact new spending programs.

At present, the improved fiscal picture has relieved worries in financial markets, which, in turn, has eased pressures on politicians to be frugal. But the budget outlook continues to be unsustainable and the squeeze on the budget will intensify as interest rates on the massive federal debt return to more normal levels. Moreover, the shock to the budget will be magnified should financial market vigilantes start to worry about their prospects for getting repaid and rising risk premiums in interest rates pour fuel on the budgetary fire. If conditions come to this, the economy—growth and the labor market—will suffer considerably as a consequence.

The Local Economy

The data and commentary which follow suggest that, with a few exceptions, local economic activity has shown slight growth over the past few months. However, growth in most sectors has slowed.
Unlike the experience of the two previous national expansions, the unemployment rate in the currently configured Wilmington Metropolitan Statistical Area (MSA), composed of Brunswick, New Hanover, and Pender Counties, has been above that of the state. The state's rate has also been above that of the nation. Growth prospects suggest no major reduction in these rates over the next 12 to 18 months. Source: Division of Employment Security, NC Department of Commerce.

As can be seen in the following chart, average monthly MSA employment gains have been relatively small. Compared to the same period following the April 2001/December 2001 national recession, employment gains in the recovery following the January 2008/June 2009 recession were substantially lower and comparable to those following the July 1990/March 1991 recession. Source: Division of Employment Security, NC Department of Commerce.
The employment growth that has taken place has not been across-the-board. Six of the ten largest employment sectors in the MSA saw employment gains between 2011 and 2012. Compared to 2007 (the year preceding the start of the most recent national recession), only four of these sectors, viz., health care and social assistance, accommodation and food services, local government, and public administration, show employment gains.

Source: Division of Employment Security, NC Department of Commerce.

Data on new incorporations send mixed messages. New incorporations rose every year over 2012-2012 in Brunswick County. Following growth in 2010, they were virtually unchanged in New Hanover County between 2010 and 2011, only to fall by more than a third over 2012. New incorporations fell over 2010 and 2011 in Pender County but rose over 2012. For the year ending June 2013 (July 2012/June 2013), they were up in Brunswick County but down in both New Hanover and Pender Counties.

Source: NC Secretary of State.
The retail sector has regained virtually all that it lost during the 2008-09 national recession. Retail sales growth was volatile over 2010-2012. Sales were up for the first four months of 2013, but at a slower pace than that for the same period in 2012.
Source: NC Department of Revenue.

Air passenger traffic at the Wilmington International Airport has been volatile since 2010. Traffic has fallen for the past two years. The declines were larger in 2012 than they were in 2011. For the year ending May 2013, both passenger enplanements and deplanements are down dramatically.
Source: Wilmington International Airport.
After rising over 2010 and 2011, container tonnage traveling through the Port of Wilmington fell by almost 7.5% over 2012 and was down 4% for the year ending May 2013.

Source: NC State Ports Authority.

The residential real estate market has stabilized and has resumed moderate growth. Since year-end 2008, sales of existing single-family homes (five-month centered moving average) have risen throughout Southeastern North Carolina, with the most recent data showing that they have rebounded to their late-2007 levels. Despite this growth, current sales in the area served by the Brunswick County Association of Realtors (Bladen, Brunswick, and Columbus Counties) are less than one-half their high in mid-2005, while the same in the area served by the Wilmington Regional Association of Realtors (Brunswick, New Hanover, and Pender Counties) are slightly more than 50% above their high in mid-2005.

Source: NC Association of Realtors.