

AS THE ECONOMY CHURNS

ANIRBAN BASU

The always entertaining and informative Anirban Basu said the economy has been in transition since 2005. This has been a decade of debt, with worsening economic imbalances. Americans have benefited from low interest rates. There has been a run-up in consumer credit, as interest rates have risen and people are not spending as much money as they did in the past. Consumers were “off to the races” until late 2005.

Mortgage rates are not as low as they were, but they are still low. New home sales have responded to low mortgage rates. Around 9/11, people bought as much house as they could not afford. There was a big jump in sales in April 2007, as homebuilders capitulated to slowing sales and slashed prices. Between 9/11 and late 2005, there was a boom in residential construction. Since then, however, residential construction has dropped, so there is less inventory. Existing home sales peaked in late 2005. Since then, sales and prices have been falling month after month.

The Mortgage Bankers Association Delinquency Rates for prime loans are way up, particularly for adjustable rate mortgages. As payments go up, households are under stress. For sub-prime loans, delinquency rates are higher, as one in seven are delinquent. Adjustable rate mortgages and sub-prime mortgages have been damaged the most.

In Maryland, the number of housing units sold went negative in 2005, and were very bad in 2006. We are nowhere near where we were.

Residential building permits per 100 households are led by Loudoun County, Virginia, with 3.41, compared to 1.39 for Washington, D.C.-Maryland-Virginia, .96 for the Baltimore-Washington corridor, and .8 in Baltimore City. There are jobs in the corridor counties, but the housing is not there. Loudoun County is the growth county for Northern Virginia; in fact, it is the fastest growing county in the United States.

The median home price in Maryland increased from less than \$130,000 in 1996 to \$290,000 in 2006. Between 2001 and 2006, the median home price in Maryland increased a whopping 142% in Somerset County, 136% in Prince George’s County, 126% in Baltimore City and 42% in Allegany County.

Currently, the hottest metro housing market in the nation is Cumberland, when measured by home price appreciation between the first quarter of 2006 and the first quarter of 2007. Cumberland has been an “oasis of affordability.” Washington County is getting more expensive, and the investor community is buying in Allegany County, where a four bedroom house costs less than \$100,000. Investors are looking for value. Between April 2006 and April 2007, active housing inventory rose in the Baltimore Metropolitan Area. The housing inventory was much higher in Baltimore City, which was affected most by the subprime meltdown. Investors are flocking to Baltimore City, buying homes and then putting them up

for rent until the market strengthens. In Suburban Maryland, the active housing inventory was way up in Prince George's County, which has older housing stock than the other counties in the area. On the Eastern Shore, not including Queen Anne's County, the largest active housing inventory was in Worcester County. The housing inventory in Western Maryland has been relatively stable.

Cash out refinancing value as a percentage of total refinance originations peaked in the second quarter of 2006. People have jobs, but they also have a lot of debt. Equity is not rising.

NYMEX crude oil futures show that oil is averaging between \$55 and \$65 a barrel. As crude oil prices have risen, Americans' personal savings rates have dropped. Americans are now spending more than they earn. Consumers are strained, living paycheck to paycheck. The spike in personal savings in late 2004 was due to the Microsoft stock dividend.

The Consumer Price Index in April 2007 showed that the leading sources of inflation were health care, other goods and services, food and beverages, housing and energy. The U. S. trade deficit dropped between January 2001 and January 2007. The value of the dollar went "way down" between January 1999 and April 2007, resulting in less foreign travel by Americans. U.S. exports increased between January 2004 and March 2007, but Maryland has not benefited as much from this growth as other states have.

Former Federal Reserve Chairman Alan Greenspan has said the U.S. economy is slowing, and there is a one in three chance the U.S. economy will enter a recession this year.

Gross Domestic Product (GDP) has fallen in recent months, but is still positive, as inventories have been rebuilt. Personal consumption was the biggest contributor to GDP growth, as consumers are driving the growth of the U.S. economy.

Approximately 157,000 jobs were added in the United States in May 2007 – a "big number." Between March 2001 and July 2002, the U.S. lost nearly 2.4 million jobs. Between May 2006 and May 2007, the U.S. added 1.925 million jobs.

How Prepared are we for the Shifting Economic Landscape?

The 2007 State New Economy Index ranks Maryland third, below top-ranked Massachusetts and #2 New Jersey. We want to be #1. Breaking down the State New Economy Index, Maryland ranks fourth in Knowledge Jobs (compared to Massachusetts' #1 ranking), second in Economic Dynamism (compared to Massachusetts' #11 ranking), third in Innovation Capacity (compared to Massachusetts' #1 ranking), 11th in Digital Economy (compared to Massachusetts' #2 ranking), and 30th in globalization (compared to Massachusetts' #4 ranking). Maryland ranks 46th in technology in schools. If the federal government is running a deficit, it can't spend money. Maryland has to be more global – we must look to the rest of the world.

Maryland's April 2007 unemployment rate of 3.6% is 14th lowest in the nation, compared to Virginia at #7, with 3.1%. North Dakota still does not count. Lowest ranked Michigan's rate (#51) of 7.1 percent will get worse due to the Chrysler sale.

In Maryland counties, Howard County had the lowest unemployment rate of 2.5% in March 2007. Worcester County ranked 24th, with an 8.1% rate, due to seasonal unemployment. The labor market is still very tight.

In Maryland non-farm employment by industry sector groups from April 2006 to April 2007, 23,900 jobs were added in Maryland, and 1.871 million jobs were added throughout the United States. Professional and business services added the most jobs, followed by leisure and hospitality and educational and health services. During the same time period, the Baltimore Metropolitan Statistical Area added 6,200 jobs, and the Washington, D.C. Metropolitan Statistical Area added 53,600 jobs.

Another Way of Thinking about Balanced Growth

Both Maryland and Massachusetts rank 11th in the top 15 states with the highest income inequality – which compares the top 5% to the bottom 20% income ratio. In terms of household share of total income between 1980, 1990 and 2000, the middle 60% of the population lost the most. To keep the middle class strong, they must earn a living wage and have opportunities to move up. Corporate profits, however, between 2001 and the end of 2006 have increased, so people who owned assets have done well.

Baltimore City had the highest poverty rate in Maryland in 2000, with Somerset and Allegany counties ranking second and third. Maryland ranks 35th in the list of healthiest states in the nation, compared to third ranked Massachusetts.

Conclusions

There is a 2/3 chance there will be no recession in Maryland.

A soft landing is the most likely outcome for 2007.

The macroeconomic imbalances are huge and widening.

The best thing the Federal Reserve can do is nothing.

The Federal Reserve Chairman will come under enormous criticism.

Maryland will hold up better than most states, with Base Realignment and Closure (BRAC), and commercialization and globalization representing economic development opportunities to restructure our socio-economic landscape.