WHAT TO EXPECT IN 2014

Despite some setbacks, our economy has managed to push forward through 2013. Will this steadiness continue in 2014?

BY CHARLIE HALL

Uncertainty has certainly been the key word over the last few months given the untimely government shutdown and the [now-expected] ritual of kicking the debt ceiling down the road. Congress was supposed to come up with some kind of budget by Dec. 13 (I am writing this before that date so it will be interesting to see if this was actually done by the time we're all reading this).

The continuing resolution funding of the government will expire on Jan. 15 and cuts associated with the 2014 sequestration will kick in then. Then the debt ceiling comes up for discussion again on Feb. 7. All of this speaks to a wild ride early in the year. Fortunately, most of the holiday spending will have occurred before then!

The Federal Reserve is expected to delay tapering until March, when Janet Yellen chairs her first Federal Open Market Committee (FOMC) meeting. So the proverbial punch bowl will be left out a little longer and short-term interest rates will be held low at least until 2015. The hope is that the Fed's promise of lower rates for a while longer will blunt the blow to financial markets when tapering does begin.

That said, economic growth in 2014 is expected to pick up from its less-than-stellar pace of 2013, led by improving consumer spending, business investment in fixed assets and homebuilding. Interest rate-sensitive sectors in the economy are also getting a lift from lower long-term interest rates. The gray area, however, is how much fiscal and monetary policy uncertainty will weigh into businesses spending plans in the coming year.

Houses are now valued greater than their pre-recession peak as home prices and the stock market have helped to restore balance sheets. However, some of the gains in home prices and the stock market have been boosted by securities purchased by the Federal Reserve (to the tune of $85 billion per month) to help keep long-term rates low.

With rates at such a low level, investors searching for better yields have put money in hard assets like homebuilding and the stock market. Many economists are concerned that once the Fed begins to scale back its asset purchases, the Fed-bolstered gains in the residential and stock market will dissipate.

Pushing Forward

Despite all of this, our economy has continued to push forward, showing the underlying resilience of the U.S. system. Private sector demand has grown at a 3.5 percent annual pace since the recession ended four and a half years ago. Some of the steadiness of the economy comes from consumers. Spending growth has started to bounce back from the sharp tax impact that slowed things down in early 2013.

Another part of the steadiness in the economy is due to a vastly improved financial situation; data from the Federal Reserve in the second quarter show that net wealth is up well over 10 percent from last year. Although we are still seeing the residual problems of the last real estate bubble in the mortgage markets, other forms of consumer credit are experiencing some of their lowest delinquency rates ever.

There is additional positive news in that problems outside of the United States seem to be waning. Europe appears to be pulling out of its downturn, with positive GDP growth in the second quarter of 2013. And it isn't just Germany; most economies in Europe are seeing better numbers.

Housing has been the brightest sector over the last two years. Even though most of the excess stock has been absorbed, the pace of home building remains at half its normal pace and one-third of what it was in 2006.

Most of the recent data on the housing sector have been on the weak side, and the most recent data on mortgage applications, builder confidence and pending home sales have continued to be disappointing. The lone exception has been home prices, which, for the most part, have continued to rebound solidly. Home prices, however, have largely risen independently of any improvement in underlying demand. This, in my opinion, is largely attributable to the influence of large investors in the housing market.

Household formations have been lagging as a growing proportion of young people are living with their parents and those who have ventured out have shown a greater propensity to double up. Even though renters have accounted for all the growth in households during the past six years, the for-sale housing market also has improved. Considerable progress has been made at clearing out inventories of foreclosures and lender-owned properties.

The recovery in home prices exaggerates the extent of the improvement in the housing market. The Case-Shiller 20-City Home Price Index has increased 12.8 percent over the past year. The largest gains have tended to be in the markets that saw the largest declines and had huge inventories of vacant properties.

The rebound in home prices is a critical building block, though, to a sustainable housing recovery. Rising prices are a sign that excess inventories are being worked down, which helps provide some clarity to the appraisal process and bolster confidence of potential homebuyers. Higher prices also mean more homeowners have enough equity to trade up to a more desirable residence. Unfortunately, this process takes time.

That being said, most housing pundits are projecting that, when the data becomes official, there will have been 930,000 housing starts in 2013, with approximately 70 percent of those being single-family homes and the remainder multi-family units.

You will remember that I wrote last January housing starts were projected to be between 1.2 and 1.5 million units. Obviously, we didn't get there, mainly due to the aforementioned reasons. So it is with a grain of salt that I mention projections are for around 1.1 million units in 2014. I do tend to agree with the pundits this time, provided Congress doesn't muck things up too much.

So the bottom line is that 2014 should be another growth year, with a mild hiccup in mid-summer as the stock market corrects itself. This will depend a lot on when the Fed starts pulling back on the throttle. In the meantime, at the risk of mixing metaphors, keep the peddle on the floor and make hay before it rains. ■

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