Northern Trust

DAILY GLOBAL
COMMENTARY

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$536 Billion Worth of Household Assets Evaporated in February?

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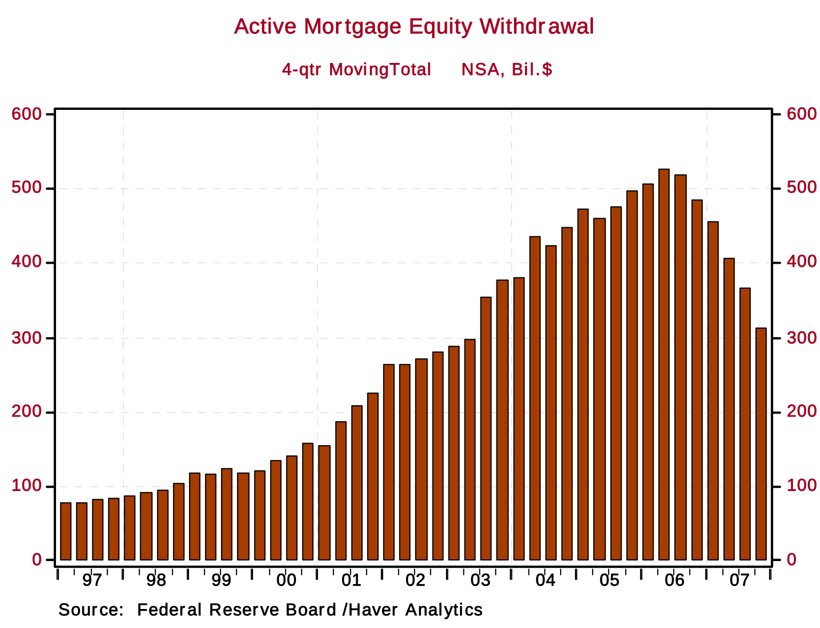
It sure is a good thing that $150 billion of checks from the IRS are in the mail to U.S. households because these same households experienced an evaporation in paper wealth in February to the tune of about $544 billion according to my admittedly back-of-the-envelope arithmetic. It was reported today that the Case-Shiller house price index for 20 major metropolitan areas fell 2.66% month-to-month in February. Applying that percentage decline in house prices to the fourth-quarter value of $20,154.7 billion for household residential real estate from the Fed's flow-of-funds data yields a decline of $536 billion. Now, this is a very rough approximation for at least two reasons. Firstly, the Case-Shiller price index is for only 20 metropolitan areas, not the whole country. So, the Case-Shiller index captures the decline in house prices in the Manhattan, New York area but not the Manhattan, Kansas area. Second, the value of residential real estate in the Fed's flow-of-funds accounts is based on the OFHEO house price index. But even with these qualifications, I feel confident in saying that the value of households' residential real estate assets fell in February by some multiple of the aggregate value of the checks households will receive as part of the Economic Stimulus Act of 2008.

Of course, the check from the IRS is cash in hand and the decline in the value of residential real estate is a "paper" loss. But when residential real estate values were going up, households were turning these "paper" gains into cash in hand by borrowing against the rising value of their houses. Back in 2006, households were extracting more than $500 billion of equity from their houses (see chart below), which was about 6% of their after-tax income. That home equity is now in full-scale retreat. Moreover, it is tougher to qualify for a mortgage or home equity loan with which to extract any remaining equity. This is one of the strong headwinds aggregate demand is experiencing now.

Chart 1



(Note: This commentary was motivated by a conversation I had with Michael Nicoletti, a renowned student of the housing market, this morning. Any errors in analysis or arithmetic are mine, not his.)

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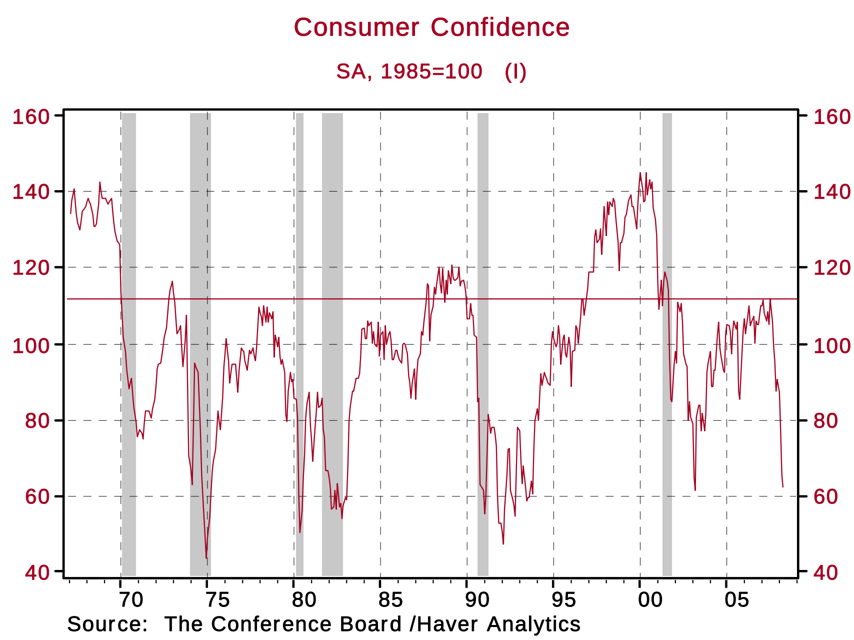
Decline in Consumer Confidence Is Justified

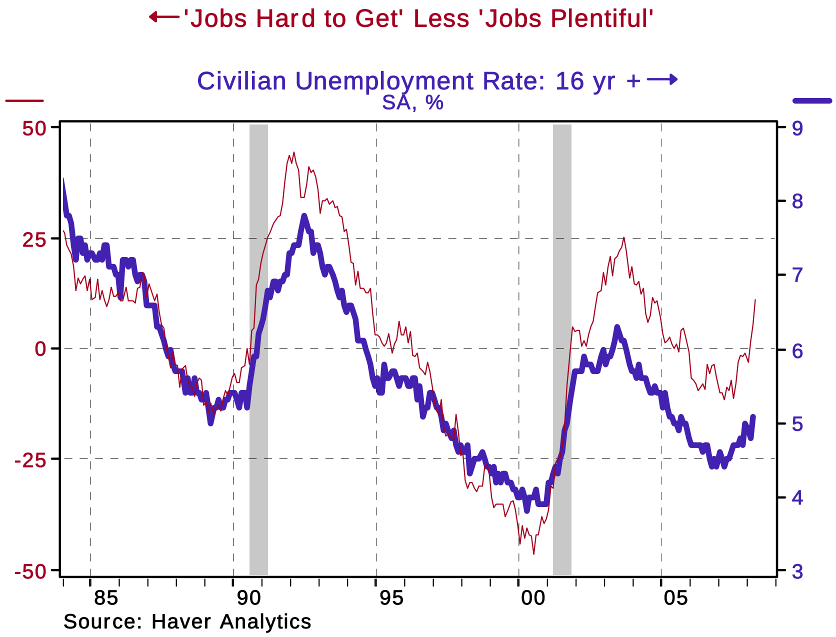
The Conference Board's Consumer Confidence Index fell to 62.3 in April from 65.9 in March. The index has now dropped 44.3% from the cycle high of 111.9 in July 2007. There are ample reasons to justify the gloomy mood of consumers – housing market crisis, rising unemployment rate, large increases in food and gasoline prices, a weak dollar, the war in Iraq, and so on. This month's reading enhances the already grim situation. Will it influence the FOMC meeting underway to a large extent? Possibly not, but it is a valid indicator that strengthens the case for a rate cut tomorrow.

Chart 1



The Present Situation Index declined to 80.7 from 90.6 in March; the Expectations Index edged up slightly to 50.1 from 49.4 in March. The net of the indexes tracking responses that indicate "jobs hard to get" and "jobs plentiful" rose to 11.3 in April, the highest since September 2004. Typically, an upward trend of this net measure is indicative of a rising unemployment rate. The unemployment rate for March was 5.1%, up from a cycle low of 4.4% in March 2007. The April employment report will be published on May 2.

Chart 2



The fact that households are in a truly tight financial position is visible in the index tracking vacation plans for next six months. This vacation plans index at 39.6 in April is the lowest since October 1978! (see chart 3)

Chart 3