

Patience Will Be Required, UH's Smith Says, As Americans Wait For Better Times For Housing Market, National Economy

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HOUSTON, November 8, 2007 – “Aug. 8, 2007, brought with it a sudden wake-up call to the nation and the world regarding the serious problems associated with sub-prime lending practices of this decade,” said Dr. Barton Smith, University of Houston professor of economics, during his bi-annual symposium at the Hyatt Regency Houston Hotel.

“On that date the Federal Reserve Bank, the Central Bank of the E.U., the Australian Central Bank and the Central Bank of Japan began pouring billions of dollars into the world’s financial markets to contain a panic that could have created a full-fledged international credit meltdown,” Smith said. “By the time they were finished, more than a quarter trillion dollars had been pumped into the markets to prevent a major collapse.”

During “Market Corrections, Crises and Collapses: History’s Lessons about Remedies and Recoveries,” Smith spoke of recent evidence regarding the impact of the sub-prime mortgage crises on the housing market and the overall economy, both nationally and here in Houston.

Alan Greenspan, former chairman of the United States Federal Reserve Board, forecast there was a 50-50 chance that the U.S. economy would end up in recession in 2008. Others are more optimistic. Here in Houston the negative impact of the national slowdown and housing market correction seems to have been much more muted, so far. Equally puzzling for analysts is the question of the likely duration of spillover-over effects of the housing market correction upon the overall economy. Smith addressed each of these questions and was generally more optimistic that the U.S. could avoid a recession, but more pessimistic regarding the length of time it would take for these housing and consumer-related problems to resolve themselves.

“Next year,” Smith said, “will be one of slow national economic growth and continued weakness in new home sales, new construction and home prices. The number of mortgage “resets”, where the interest rates on adjustable rate mortgages that often began with teaser rates are to be reset to current interest rate levels, will continue to climb until they peak in March of next year at about \$110 billion dollars in that month alone. The mortgage market will be on shaky ground until we get past this hurdle next spring, and foreclosures are not likely to peak until three to six months later. The severity of the home market correction will be ameliorated to some degree by low fixed-rate mortgage interest rates, but this will only help “qualified” buyers to get refinancing. For the millions of unqualified buyers who were squeezed into the owner-occupied market over the past four years, there is likely to be little alternative but to simply bail out.”

"But the foreclosure problem is not the only storm we face," Smith said. "Problems of excessive consumer debt and of seriously low home affordability will also plague the nation's economy and housing market. These problems will not correct themselves overnight. As a result, they will create a drag on the national economy for much of the rest of this decade. Add to these the burden of higher energy prices and the American consumer will struggle for some time to keep his head above water."

In Houston, the economic slowdown, though present, is less severe, Smith said. The region's upstream energy sectors related to oil and natural gas exploration are still growing, though at a somewhat slower pace than last year. Growth in the city's non-energy economic base is slipping in tandem with the national slowdown and many of the region's large secondary sectors have become stagnant in anticipation of a spillover from the nation's economic malaise. Still, it is expected that Houston will end up adding about 70,000 jobs this year once all the data has come in, and while 2008 will see even slower growth, job creation should, nonetheless, be almost 50,000.

"Two threats cloud next year's picture for Houston," Smith warned. "It is highly likely that the city will not receive as strong a stimulus from energy in 2008 as in 2006 and 2007. Everyone is focusing in on oil prices as a sure sign that Houston's economy will continue to boom, but natural gas prices are much more subdued and, in the absence of an unusually cold winter, are likely to remain at current levels. Since most domestic exploration is related to natural gas, it is likely that we will see a continuation of the recent slowdown in the growth rate in Houston's energy economy as well. If exploration merely stabilizes at current levels, Houston will lose much of the benefit of upstream energy job growth that has set it apart from the rest of the nation."

The second cloud on Houston's horizon is associated with a continued slowdown in the region's own housing market. "While the effects of the national housing market correction will be much less severe in Houston, the absence of sub-prime lending will also reduce the size of the market of new home buyers locally," Smith said. "We were simply building homes at a pace that was faster than could be absorbed by growth in fully "qualified" new home buyers. This doesn't mean that new home construction will collapse in Houston as it has in some parts of the country, merely that the current pace, which has already fallen by about 25 percent, will likely fall somewhat more before the market stabilizes." Smith said, "Job growth is likely to slow to around 2.2 percent in 2008 and rebound only slightly to 2.5 percent in 2009. That contrasts with this year's growth of nearly 3 percent and last year's growth of slightly more than 4 percent. Still, Houston's economy is likely to outperform the national economy for the rest of this decade. Furthermore, as the housing market stabilizes and the national economy begins to regain some steam, local job growth will not only head back up toward 3 percent per year, but it will be more evenly balanced between energy and non-energy."