Oklahoma
Economic
Digest

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Decade of Transformation Sets Up Next Generation of Growth

We complete our new year of the new decade's trilogy this month focusing on the happy ending to this decade of transformation now upon us, the third such period in a century. That's the good news: as the conclusion of decade-long transformations led to rising prosperity and rising standards of living for a generation on two other occasions in recent history, so shall we set ourselves up for another similar period of economic health at the conclusion of the current transformation. It will result, again, in a better standard of living for our children and grandchildren. It may be a *different* better standard of living, one measured in satisfaction and the enjoyment of life as opposed to one measured by how much "stuff," and the value of said stuff, we can accumulate, but it will be better nonetheless.

Warren Buffett says "Don't bet against the USA," and we certainly are inclined to agree. Over and over we have proven ourselves clever enough to solve not only our own problems, but often the problems of a troublesome planet as well. The bad news, and you knew there had to be some bad news: it will take the greater part, if not all, of a very difficult decade, to accomplish this transformation. Not unlike some personal experiences, in which a thoroughly enjoyed party inevitably results in the next-day's hangover, as a nation we now are atoning for nearly two-decades worth of excesses: excess consumption, excess debt creation and excess deficit spending (individuals, businesses and governments).

We've *pre-consumed*, as it would now appear, maybe a decade's worth of houses and automobiles, in particular, but all manner of consumer goods which now almost seem designed to be used gently then disposed of in favor of newer, better, faster, sometimes cheaper models. January's new home and existing home sales data reflect this new reality (data, page two), even with significant taxpayer subsidies to stimulate purchases and low-down-payment (3.5 percent) FHA financing now accounting for 40 percent of new mortgages. 2009's vehicle sales of 10.43 million units, down from an average 16+ million annual sales in the Aughts, may look good by comparison by the end of this decade as more Americans choose to keep and maintain cars long after the monthly payments end.

Planned obsolescence now is accompanied by "innovative obsolescence," on display nowhere more clearly than in consumer electronics and information technology, where whatever it is one is removing new from its packaging already is outdated by what's on the drawing board, or already in production, at the factory. Televisions, cell phones, personal digital assistants, personal computers and digital readers all fall into this category, and, at least until recently for some of us, we as consumers have been able and willing to swap out and dispose of perfectly serviceable units with alarming regularity. (Ironically, the cost of new personal technology now pales in comparison to the annual costs of the attendant servicing fees – digital cable television, high-speed internet, satellite radio and cellular telephone/data subscriptions, which is why some items, like cell phones, are "given away" in exchange for two-year financial commitments, much as Kodak used to give away inexpensive cameras to create more film demand.

An "average" U.S. household now can spend nearly $5,000 annually for information and entertainment compared with the inflation-adjusted $100 a year for a hard-wired basic telephone service in 1975.) Meanwhile, back to our regularly scheduled Great Transformation of the Teens, which we think will be characterized more by deflationary forces, in asset prices at least, than the inflation/hyperinflation about which many hysterical, doom-and-gloom bloggers are hyperventilating. Despite absolute certainty we will be proven wrong about most of these musings, we offer them notwithstanding.

Home values are likely to continue falling (in almost all areas of the nation) throughout the decade, as a result of a combination of factors including Baby Boomer downsizing, a significant overhang of availability of both single-family and multi-family residences (more than 20 million vacant units already), a return to more traditional 80 percent loan-to-value mortgage options, increasing real estate taxes, delayed and reduced family formation among the Echo Boomers and perhaps most importantly, rising mortgage rates above the current artificial, government-policy-induced 5.00% fixed rate terms.

On the latter, let's do some math: A family which can afford a $1,300/month P+I house payment today can buy a $250,000 home with 5.00% FHA 30-year fixed rate financing requiring 3.5 percent down ($8,750). At an 8.00% fixed rate, if FHA-type low down payment financing exists in a decade, the family would qualify for a $176,000 mortgage which allows the purchase of a home priced at $182,400, nearly $70,000 below today's purchasing power. Only by adding more skin to the game, significantly larger down payments, for example, will higher priced homes be available to families should interest rates rise even modestly. (Which is why we expect by decade's end a far more commonplace return to multiple generations living in the same household as parents, children and grandparents grapple with the economic realities of deflation.)

Home prices are not the only arena in which deflationary forces will emerge. Dust-ups already are a brewin' across the land in regard to salary and benefit packages of public employees as precipitous declines in tax revenues and investment return uncertainties wreak havoc upon municipal and state finances and a pocketbook-motivated electorate refuses to further sanction compensation plans mostly unavailable in the private sector. Much as General Motors and Chrysler recently used bankruptcy courts to rid themselves of expensive labor agreements, we expect many cities and counties to at least threaten similar action under heretofore infrequently used Chapter 9 bankruptcy provisions to address the imbalances which have accumulated over a generation.

So where's the happy ending at the end of what clearly will be a difficult decade? We use history as a guide, in that after the Great Depression of the 1930s and the Great Recession of the 1970s, these challenging transformations led to economic renewals lasting a generation. We have every reason to believe the Great Transformation of the Teens will set up a similar outcome and that, as a nation, we will be stronger for it.

U.S. Economy at a Glance

Category	As Of	Rate	Previous	Trend
Real Gross Domestic Product (% Annualized)	4Q2009, 2nd Rev	+5.9%	+2.2%	Increasing
Real Personal Consumption Expends (% Monthly)	Jan 2010	+0.3%	+0.1%	Increasing
Real Disposable Personal Income (% Monthly)	Jan 2010	(0.6%)	+0.2%	Decreasing
Personal Savings Rate (% Annualized)	Jan 2010	+3.3%	+4.2%	Decreasing
Consumer Price Index (% YOY)	Jan 2010	+0.2%	+0.2%	Stable
Producer Price Index – Fin. Goods (% YOY)	Jan 2010	+1.4%	+0.4%	Increasing
U-3 Unemployment (Headline) Rate (%)	Feb 2010 (est)	+10.0%	+9.7%	Increasing
U-6 Unemployment Rate (%, Incl. PT/Marginal)	Feb 2010 (est)	+17.0%	+16.5%	Increasing
Retail & Food Service Sales (% Annualized)	Jan 2010	+0.5%	(0.1%)	Increasing
Automobile/Light Truck Sales (Annualized)	Feb 2010 (est)	10,200,000	10,700,000	Decreasing
Single-Family Housing Starts (Annualized)	Jan 2010	484,000	477,000	Increasing
Single-Family New Home Sales (Annualized)	Jan 2010	309,000	329,000	Decreasing
Existing Home Sales (Annualized)	Jan 2010	5,050,000	5,450,000	Decreasing
Crude Oil, WTIC, Cushing, OK ($/bbl)	Feb 2010	$79.66	$72.89	Increasing
Natural Gas ($/mmBTU)	Feb 2010	$ 4.81	$5.13	Decreasing
Fed Funds Actual/Target Rate (%)	Feb 2010	0.12%/0.25%	0.13%/0.25%	Stable
10-Year Treasury Bond (%)	Feb 2010	3.61%	3.58%	Stable
30-Year Treasury Bond (%)	Feb 2010	4.56%	4.49%	Stable
30-Year Fixed Rate Mortgage (%)	Feb 2010	5.08%	5.07%	Stable